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SUBJECT: IRAQ COMPACT: FRENCH FINANCE MINISTRY OPEN TO
PROPOSAL, BUT EXPRESSES CONCERNS

REF: STATE 109400

Classified By: Acting Deputy Chief of Mission Thomas White for reasons
1.4 (b) and (d)

¶1. (C) Summary: Deputy Secretary Kimmitt and Counselor Philip
Zelikow met July 17 with Xavier Musca, Director General of
the Treasury and Economic Policy in the French Ministry of
Finance to discuss the Iraq Compact. Musca expressed support
for the goals of the Compact, but expressed concerns about
its timing, its degree of regional support, and its
feasibility given the current political and security
situation in Iraq.

The Compact

¶1. (C) Deputy Secretary Kimmitt began by outlining the U.S.
view of the Compact, noting that this was the beginning of a
process of evaluating needs and coordinating with
international organizations and donor countries, not an
exercise seeking to raise funds immediately. That could only
come when needs (such as greater transparency in government
or oil revenue-sharing arrangements) were clearly
established; and when costs and resources already available
to the Iraqi government had been evaluated. Interested
parties would begin working on this when they met in Baghdad
July 20, with a view toward concluding it at an international
conference in November. D/S Kimmitt noted that Iraq had
strong economic potential, but that reforms were necessary in
both the political and political-economic domains for it to
realize that potential. Strong multilateral support was an
essential element of the Compact.

The Example of Lebanon

¶2. (C) DG Musca began his response by evoking the situation
in Lebanon, which he thought was a useful example for
brainstorming about linkages between political and economic
reform and the role of the international community. In
Lebanon the effort had failed, in part because there was no
formalized process or commitments implemented by a core group
with shared values, but also in part because the continued
presence of Hezbollah had prevented delivery of real
political and security reform, without which economic reforms
had proved impossible. Musca emphasized that the GOF is
willing to consider the idea of a Compact for Iraq, and
intended to send a representative to Baghdad July 20. He
nonetheless noted that the proposed schedule was very

ambitious, given the political hurdles Iraq would have to overcome between now and then to be in a situation to benefit from the Compact. Iraq is fundamentally a wealthy country that did not need international financial assistance over the long term. Insecurity and political uncertainty still prevent significant investment in the country. He inquired about the results of the IMF review which had been discussed in a recent meeting in Amman.

Iraq's Progress

13. (C) D/S Kimmitt stressed that while problems remained, the IMF was generally pleased with Iraq's progress under the Stand-by Agreement (SBA) to date. The IMF believed Iraq was ahead of schedule in reducing fuel subsidies. Iraq's oil production is back up to pre-war levels, and is being sold at higher prices. The Government of Iraq had made progress in budgeting and procurement, and in paying wages, pensions and subsidies. Corruption clearly remained, particularly in the energy sector, and more needed to be done to reduce pension payments. What Iraq needs are the resources to undertake productive capital investment. Kimmitt stated that France could help with advice about how to build capacity in the Ministries. In fact, D/S Kimmitt did not disagree with Musca's suggestion that perhaps a similar Compact would be a good idea for Lebanon: Hezbollah drew its strength in part from providing services the government did not. But Lebanon would need to demonstrate, as have the Iraqis in the SBA, that they can discharge commitments made.

14. (C) D/S Kimmitt emphasized that though the Compact's timetable is ambitious, the Iraqis had already done a great

PARIS 00004980 002 OF 003

deal of evaluative spadework in working with the IMF and others, and the Compact could reinforce political changes in important ways. It could be used to deal with tough issues not resolved in the Constitution (such as sharing of oil revenues); to reduce government corruption, which was clearly visible in areas such as the oil sector; and to create clear rules for investment that are essential for companies to be more willing to invest in Iraq. The lever of international commitment was needed to help Iraq make progress; the important point was to get started and see how quickly reform advanced.

How much regional support?

15. (C) DG Musca raised the issue of how much regional support the Compact might enjoy, particularly from Arab states that had been slow to aid Iraq so far, and from Turkey which might be politically resistant due to long-standing issues such as Kurdistan. D/S Kimmitt said that the Gulf states had made generous commitments at Madrid but issues such as disbursement of these funds, as well as debt and reparations remain. The Iraqis and we still need to engage this problem at a political level. Counselor Zelikow agreed that the Gulf Arab states needed to be participants. Turkey was different, and the regional issues involved were of much greater complexity. In his view, though we needed to acknowledge these political problems, we should not emphasize them.

Managing scarce resources

16. (C) Counselor Zelikow said that France needed to make a strategic choice about how it wanted to participate in the future of Iraq. France had much to contribute to the formulation of objectives for political and economic change in Iraq, and in advancing this process. DG Musca said that

from his perspective in the Ministry of Finance, the question was how best to use scarce resources. Was there a sufficiently developed political foundation to merit investing money in Iraq? Other ministries would be the leaders in formulating the GOF's opinion about Iraq's political progress. Musca was not convinced that international involvement was a key factor: the Iraqis themselves had to decide they wanted to create a viable state. D/S Kimmitt agreed, but recalled his earlier point that economic reform could help reinforce the message to the Iraqi people that there was tangible value in creating a functional unified state.

Embassy Comment

¶17. (C) Though outlining broad agreement with the goals of the Compact, Musca's comments clearly show the depth of concern about security, political stability and the will to fight corruption that have led the GOF thus far to limit its aid to Iraq. Though other ministries clearly have the lead in evaluating progress, the holders of the French purse strings will want to see demonstrable and sustainable progress before they will engage major new sums to aid Iraq.

Participants:

¶18. (SBU) France:

Xavier Musca, Director General of the Treasury and Economic Policy, Ministry of Finance (DGTPE)
Raymond Fernandez, Director, DGTPE International and Development Affairs
Giles Pelissier, Deputy Director, DGTPE International and Development Affairs

U.S.:

Robert Kimmitt, Deputy Secretary of Treasury
Philip Zelikow, Counselor to the Secretary
Admiral Robert Moeller, CENTCOM
Evangelina Bouzis, NSC Director for Iraq
Karen Mathiasan, Director for Middle East and Africa, Dept.

PARIS 00004980 003 OF 003

of Treasury
Thomas White, Minister-Counselor for Economic Affairs,
Embassy Paris
Mark Motley, Embassy Notetaker

¶19. (U) This cable was cleared by D/S Kimmitt and Counselor Zelikow.
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<http://www.state.sgov.gov/p/eur/paris/index.cfm>

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